

## Internal Revenue Service, Treasury

## § 1.514(d)-1

1993-5 I.R.B. 42, February 1, 1993, is satisfied. (See § 601.601(d)(2)(ii)(b) of this chapter).

(3) *Periods after June 24, 1990, and prior to December 30, 1992.* To satisfy the requirements of section 514(c)(9)(E) with respect to partnership agreements entered into after June 24, 1990, property acquired by partnerships after June 24, 1990, and partnership interests acquired by qualified organizations after June 24, 1990, (other than a partnership interest that at all times after October 13, 1987, and prior to the acquisition was held by a qualified organization) to which paragraph (n)(2) of this section does not apply, paragraphs (a) through (m) of this section must be satisfied as of the first day that section 514(c)(9)(E) applies with respect to the partnership, property, or acquired interest. For this purpose, paragraphs (a) through (m) of this section will be treated as satisfied if the guidance in sections I through VI of Notice 90-41, 90-1 C.B. 350, (see § 601.601(d)(2)(ii)(b) of this chapter) has been followed.

(4) *Periods prior to the issuance of Notice 90-41.* With respect to partnerships commencing after October 13, 1987, property acquired by partnerships after October 13, 1987, and partnership interests acquired by qualified organizations after October 13, 1987, to which neither paragraph (n)(2) nor (n)(3) of this section applies, the Internal Revenue Service will not challenge an interpretation of section 514(c)(9)(E) that is reasonable in light of the underlying purposes of section 514(c)(9)(E) (as reflected in its legislative history) and that is consistently applied as of the first day that section 514(c)(9)(E) applies with respect to the partnership, property, or acquired interest. A reasonable interpretation includes an interpretation that substantially follows the guidance in either sections I through VI of Notice 90-41, (see § 601.601(d)(2)(ii)(b) of this chapter) or paragraphs (a) through (m) of this section.

(5) Material modifications to partnership agreements. A material modification will cause a partnership agreement to be treated as a new partnership agreement in appropriate cir-

cumstances for purposes of this paragraph (n).

[T.D. 8539, 59 FR 24928, May 13, 1994, as amended by T.D. 9047, 68 FR 12825, Mar. 18, 2003]

### § 1.514(d)-1 Basis of debt-financed property acquired in corporate liquidation.

(a) If debt-financed property is acquired by an exempt organization in a complete or partial liquidation of a corporation in exchange for its stock, the organization's basis in such property shall be the same as it would be in the hands of the transferor corporation, increased by the amount of gain recognized to the transferor corporation upon such distribution and by the amount of any gain which is includible, on account of such distribution, in the gross income of the organization as unrelated debt-financed income.

(b) The application of this section may be illustrated by the following example:

*Example.* On July 1, 1970, T, an exempt trust, exchanges \$15,000 of borrowed funds for 50 percent of the shares of M Corporation's stock. M uses \$35,000 of borrowed funds in acquiring depreciable assets which are not used at any time for purposes described in section 514(b)(1) (A), (B), (C), or (D). On July 1, 1978, and for the 12-month period preceding this date, T's acquisition indebtedness with respect to M's stock has been \$3,000. On this date, there is a complete liquidation of M Corporation to which section 331(a)(1) applies. In the liquidation T receives a distribution in kind of depreciable assets and assumes \$7,000 of M's indebtedness which remains unpaid with respect to the depreciable assets. On this date, M's adjusted basis of these depreciable assets is \$9,000, and such assets have a fair market value of \$47,000. M recognizes gain of \$6,000 with respect to this liquidation pursuant to sections 1245 and 1250. T realizes a gain of \$25,000 (the difference between the excess of fair market value of the property received over the indebtedness assumed, \$40,000 (\$47,000-\$7,000) and T's basis in M's stock, \$15,000). A portion of this gain is to be treated as unrelated debt-financed income. This amount is determined by multiplying T's gain of \$25,000 by the debt/basis percentage. The debt/basis percentage is 20 percent, the ratio which the average acquisition indebtedness (\$3,000) is of the average adjusted basis (\$15,000). Thus, \$5,000 (20 percent of \$25,000) is unrelated debt-financed income. This amount and the gain recognized pursuant to sections 1245 and 1250 are added to M's basis to determine T's basis

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in the property received. Consequently, T's basis in the property received from M Corporation is \$20,000, determined as follows:

|   |         |
|---|---------|
| M Corporation's adjusted basis .....  | \$9,000 |
| Gain recognized by M Corporation on the distribution .....                            | 6,000   |
| Unrelated debt-financed income recognized by T with respect to the distribution ..... | 5,000   |
| T's transferred basis .....   | 20,000  |

[T.D. 7229, 37 FR 28153, Dec. 21, 1972]

#### § 1.514(e)-1 Allocation rules.

Where only a portion of property is debt-financed property, proper allocation of the basis, indebtedness, income, and deductions with respect to such property must be made to determine the amount of income or gain derived from such property which is to be treated as unrelated debt-financed income. See examples 2 and 3 of paragraph (b)(1)(iii) of § 1.514(b)-1 and examples 1, (2), and (3) of paragraph (b)(3)(iii) of § 1.514(b)-1 for illustrations of proper allocation.

[T.D. 7229, 37 FR 28153, Dec. 21, 1972]

#### § 1.514(f)-1 Definition of business lease.

(a) *In general.* The term *business lease* means any lease, with certain exceptions discussed in paragraph (c) of this section, for a term of more than 5 years of real property by an organization subject to section 511 (or by a partnership of which it is a member) if at the close of the organization's taxable year there is a business lease indebtedness as defined in section 514(g) and § 1.514(g)-1 with respect to such property. For the purpose of this section the term *real property* and the term *premises* include personal property of the lessor tax-exempt organization leased by it to a lessee of its real estate if the lease of such personal property is made under, or in connection with, the lease of such real estate. For amounts of business lease rents and deductions to be included in computing unrelated business taxable income for taxable years beginning before January 1, 1970, see § 1.514(a)-2.

(b) *Special rules.* (1) In computing the term of the lease, the period for which a lease may be renewed or extended by reason of an option contained therein shall be considered as part of the term. For example, a 3-year lease with an op-

tion for renewal for another such period is considered a lease for a term of 6 years. Another example is the case of a 1-year lease with option of renewal for another such term, where the parties at the end of each year renew the arrangement. In this case, during the fifth year (but not during the first 4 years), the lease falls within the 5-year rule, since the lease then involves 5 years and there is an option for the sixth year. In determining the term of the lease, an option for renewal of the lease is taken into account whether or not the exercise of the option depends upon conditions or contingencies.

(2) If the property is acquired subject to a lease, the term of such lease shall be considered to begin on the date of such acquisition. For example, if an exempt organization purchases, in whole or in part with borrowed funds, real property subject to a 10-year lease which has 3 years left to run, and such lease contains no right of renewal or extension, the lease shall be considered a 3-year lease and hence does not meet the definition of a business lease in section 514(f) and paragraph (a) of this section. However, if this lease contains an option to renew for a period of 3 years or more, it is a business lease.

(3) Under the provisions of section 514(f)(2)(B) a lease is considered as continuing for more than 5 years if the same lessee has occupied the premises for a total period of more than 5 years, whether the occupancy is under one or more leases, renewals, extensions, or continuations. Continued occupancy shall be considered to be by the same lessee if the occupants during the period are so related that losses in respect of sales or exchanges of property between them would be disallowed under section 267(a). Such period shall be considered as commencing not earlier than the date of the acquisition of the property by the tax-exempt organization or trust. This rule is applicable only in the sixth and succeeding years of such occupancy by the same lessee. See, however, paragraph (c)(3) of this section.

(c) *Exceptions.* (1) A lease shall not be considered a business lease if such lease is entered into primarily for a purpose which is substantially related